State and Federal Statutory Provisions Governing Investment of Bond Proceeds

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WHERE DO YOU LOOK FOR PERMITTED INVESTMENT REQUIREMENTS?

STATE LAW – Set forth in special bond acts, issuer enabling legislation or general laws.

FEDERAL TAX LAW – Limitations on the yield on investments; requirements for rebate of investment income to the IRS.

STATE LAW

GENERAL OBLIGATION BONDS AND MUNICIPAL MONIES

1. Look at Special Bond Act if you have one.
2. Look at RI General Laws applicable to general obligation bonds
3. Look at State Investment Commission “Additional Investment Powers” statute
4. Look at Ocean State Investment Pool statute
5. Look at Reserve Funds statute
6. Look at Collateralization of Public Deposits statute

What is the Prudent Person Standard?

Investments made as would be done by prudent persons of discretion and intelligence in these matters who are seeking a reasonable income and preservation of their capital!

Special Bond Acts

TYPICAL LANGUAGE (Paraphrased)

Permits proceeds of bonds or notes to be deposited or invested **in demand deposits, time deposits or savings deposits in banks which are members of the Federal Deposit Insurance Corporation or in obligations issued or guaranteed by the United States of America or by any agency or instrumentality thereof** or as may be provided in any other applicable law of the state of Rhode Island.

Rhode Island General Laws applicable to general obligation refunding bonds and notes

§ 45-12-5.2. Issuance of refunding bonds to pay outstanding bonds. (Paraphrased)

While the proceeds of refunding bonds are held in trust they may be invested in **obligations of the United States of America, the state of Rhode Island, or its political subdivisions**.

Rhode Island General Laws applicable to general obligation bonds

§ 45-12-28. Permitted temporary investments for bond proceeds. (Paraphrased)

Bond and note proceeds may to be invested in **investments described in § 35-10-11**. (State Investment Commission Statute)

Rhode Island General Laws applicable to general obligation bonds

§ 35-10-11. Additional investment powers. (Paraphrased)

The state, any state agency, any city or town, and any municipal agency which has any funds not immediately required for other purposes may invest in:

(1) **Deposits in banks, savings banks, national banks or trust companies, loan and investment companies, credit unions; and in shares of building-loan associations**; which has a deposit-taking facility within this state; subject to the "prudent person standard".

State Investment Commission "Additional Investment Powers"

(2) **Shares or units of beneficial interest of any open end investment company or association or investment trust which is registered under the federal Investment Company Act of 1940**, 15 U.S.C. § 80a-1 et seq.; provided, that the company, association, or trust shall:

(i) Limit the ownership of its shares or units solely to this state, state agencies, cities and towns of this state, and municipal agencies thereof;

(ii) Invest solely in securities and investments which are lawful for investments of savings deposits as set forth and defined in chapter 19-3 of title 19; and

(iii) Invest in obligations which meet the prudent person standard.

State Investment Commission "Additional Investment Powers"

(3) **Notwithstanding the provisions above, the state, state agencies, cities and towns and municipal agencies may invest in**:

(i) **Obligations issued or guaranteed by the United States government or any agency or instrumentality and repurchase agreements fully collateralized thereby, or in securities of any open end investment company or association or investment trust, custodial arrangement, or pool which is registered under or exempt from the federal Investment Company Act of 1940**, provided, that the portfolio of the company, association, trust, custodial arrangement, or pool **is limited to obligations issued or guaranteed by the United States government or any agency or instrumentality thereof and repurchase agreements fully collateralized thereby and that the company, association, trust, custodial arrangement, or pool takes delivery of the collateral** either directly or through an authorized custodian, agent, or depository; and

(ii) **Any security of a state or political subdivision, or in securities of any open end investment company or association or investment trust, custodial arrangement, or pool** which is registered under or exempt from the federal Investment Company Act of 1940, provided, that

State Investment Commission "Additional Investment Powers"

(A) The portfolio is limited to state or political subdivision securities and repurchase agreements fully collateralized thereby;

(B) The company, association, trust, custodial arrangement, or pool takes delivery of the collateral either directly or through an authorized custodian or depository;

(C) The interest on the securities is exempt from federal income taxation;

(D) At the time of the investment, the security has a rating as determined by a national rating agency of municipal obligations equal or superior to the last rating by the agency applicable to general obligations of the state or the fund invests solely in securities having these ratings;

(E) In connection with the investments, the state, state agency, city, town, or municipal agency may enter into contracts to purchase and resell the investments at specified or determinable prices.

State Investment Commission "Additional Investment Powers"

(4) **Notwithstanding the provisions of subdivision (1),** the state, state agencies, municipalities and municipal agencies may invest in **certificates of deposit** obtained in accordance with the following conditions:

(i) The funds are initially invested through a financial institution as defined in subdivision 19-1-1(7) or chapter 19-1, selected by the investing governmental entity;

(ii) The selected financial institution arranges for the deposit of the funds in certificates of deposit in one or more federally insured banks or savings and loan associations, for the account of the governmental entity;

(iii) The full amount of the principal and accrued interest of each certificate of deposit is insured by the Federal Deposit Insurance Corporation;

(iv) The selected financial institution acts as custodian for the governmental entity with respect to the certificates of deposit issued for the governmental entity's account; and

(v) At the same time that the governmental entity's funds are deposited and the certificates of deposit are issued, the financial institution receives an amount of deposits from customers of other banks and savings and loan associations, wherever located, equal to the amount of funds initially invested by the governmental entity through the selected financial institution.

(5) **Public deposits placed in accordance with the conditions prescribed in this subsection shall not be required to be secured by eligible collateral as set forth in chapter 35-10.1.**

Ocean State Investment Pool Statute

§ 35-10.2-8. Participation units. (Paraphrased)

The general treasurer is authorized to sell participation units in **OSIP** to all agencies, authorities, commissions, boards, municipalities, political subdivisions, and other public units of the state.

Reserve Fund Statute

§ 45-11-1. Establishment and use of funds. (Paraphrased)

The city or town council and voters of any town in this state in a financial town meeting, may vote:

(1) To establish a fund to be designated as a reserve fund available as necessary for temporary borrowings in anticipation of taxes, but otherwise available only for capital expenditures;

* * *

(3) Reserve Funds may be invested in **savings accounts or certificates of deposit of commercial or savings banks or trust companies, or in obligations of the United States or its agencies, or in any other short term investment, subject to the prudent person standard.**

FEDERAL TAX LAW

Two questions for investment income on tax-exempt bond proceeds:

1. Can you earn it?

2. Can you keep it?

FEDERAL TAX LAW

Can you earn it?

You can qualify under the arbitrage rules to invest at an unrestricted yield for 3 years for "new money" issues if you reasonably expect to spend at least;

- 85% of "spendable proceeds" within 3 years; and
- Invest not more than 50% of the proceeds in investments having a guaranteed yield for 4 years or more.

(Although you can earn an unrestricted yield, you may have to rebate earnings to the federal government.)

FEDERAL TAX LAW

Yield Restriction

Bond proceeds may <u>not</u> be invested in investments earning a yield higher than the yield of the bond issue, <u>except</u> for investments

(i) during one of the temporary periods permitted under the regulations (including the initial three year temporary period described on prior page),

(ii) in a reasonably required reserve or replacement fund (e.g., a Debt Service Reserve Fund) or

(iii) in an amount not in excess of the lesser of 5% of the sale proceeds of the issue or $100,000 (the “minor portion”).

FEDERAL TAX LAW

Can you keep it?

If bond proceeds are permitted to be invested at a yield in excess of the yield on the bonds (under one of the exceptions to yield restriction referred to above), rebate payments may be required to be made to the U. S. Treasury (unless you can meet an exception from rebate).

- First installment due no later than 60 days after the end of the fifth anniversary of each bond issuance;
- Succeeding installments at least every five years;
- Final installment no later than 60 days after retirement of last bond in the issue.

FEDERAL TAX LAW

Exceptions to Rebate

Six month Exception – spent within 6 months

Qualified Small Issuer Exception – issuer will issue less that $5,000,000 in the calendar year

FEDERAL TAX LAW

Eighteen-Month Expenditure Exception –

At least 15% of expected bond proceeds actually are spent within six months

At least 60% are spent within twelve months and

100% of actually are spent within eighteen months

FEDERAL TAX LAW

Two-Year Construction Expenditures Exception

Construction expenditures include costs of reconstruction and rehabilitation, but do not include costs of acquiring any interest in land or other existing real or personal property.

Exemption from rebate if proceeds in fact are spent at least as quickly as follows:

- 10% within six months
- 45% within twelve months
- 75% within eighteen months
- 100% within twenty-four months

QUESTIONS AND ANSWERS

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